

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

June 30, 2006

Dear Xxxxx:

This letter is in response to your letter dated April 7, 2005, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We respectfully request a sales tax private letter ruling on behalf of our client (hereinafter 'Corporation'), who wishes to remain anonymous at this time. We request written guidance as to the taxability of transactions as stated below. We have offered our contention and discussion based on the following facts:

SUMMARY OF FACTS

Corporation is a provider of data storage, storage management and data protection solutions. Currently, Corporation has contracts with Illinois customers to provide various products and services including software, hardware, maintenance, services, and interfacing (hereinafter 'multiple-element arrangements').

In general, customers of 'multiple-element arrangements' place higher value on products than services. On the invoice, Corporation allocates service revenue and products (e.g., software, hardware, etc.) revenue in accordance with Corporation's arrangement with its customer. Corporation collects sales tax based on the purchase price shown on the invoice.

For financial reporting ('GAAP') purposes, revenue of 'multiple-element arrangements' contracts is allocated based on the provisions of EITF 00-21, 'Revenue Arrangements

with Multiple Deliverables.’ In accordance with these provisions, service revenue is recorded at its stand-alone fair market value based on Vendor-Specific Objective Evidence (VSOE) or other means of determining fair value. The remaining revenue (primarily for products and software) is recognized as the total arrangement value less the fair value assigned to the services.

As a result, Corporation accrues sales tax for financial reporting purposes based on a tax base that is different than the tax base on the customer invoices.

CONTENTION

Corporation should remit sales tax based on invoice price instead of using amounts included on financial statements.

DISCUSSION

Pursuant to Code of Illinois Sections 120/2-10, Illinois sales tax is calculated based on gross receipts from sales of tangible personal property made in the course of business. Gross receipts are consideration actually received by the seller.¹

Although Corporation's valuation methodology for GAAP purposes is different than its valuation on sales invoices, the amount on customer invoices is subject to the Illinois sales tax as this amount represents the amount of the sale as agreed to by Corporation and its customer. For this purpose, how the Corporation reports its revenue for GAAP purposes is irrelevant.

We respectfully request written guidance as to the application of sales tax on ‘multiple-element arrangements.’ As indicated above, we believe that sales tax should be remitted based on invoice price instead of using amounts included on financial statements.

We appreciate your assistance in this matter. If you have any questions or require additional information, please call me.

DEPARTMENT’S RESPONSE:

From the limited information provided, it appears your client may be making both retail sales of tangible personal property (i.e. sales of hardware, software) and providing a service (i.e. storage of data). We hope the following general information will aid you in determining your client’s tax liabilities.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling tangible personal property at retail. See 35 ILCS 120/2. A "sale at retail" is defined as "any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property..." See 86 Ill. Adm. Code 130.201. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 35 ILCS 105/3. These taxes work together to tax tangible personal property sold at retail.

In a retail sales transaction, you are correct that Retailers' Occupation Tax is imposed on the gross receipts from that sale. In a service transaction, if the charge for the tangible personal property

being transferred is separately stated on the invoice to the customer, then that separately stated amount would be subject to tax (please see the first tax base described below in our discussion of Service Occupation Tax).

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways:

- (1) separately stated selling price of tangible personal property transferred incident to service;
- (2) 50% of the servicemen's entire bill;
- (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or
- (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such

de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

EEB:msk

¹ Ill. Adm. Code Sec. 130.401.